

## Internal Revenue Service

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Department of the Treasury

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PLR-124837-19

Date:

April 16, 2020

### Legend

Taxpayer =

Accountant =

Year 1 =

Year 2 =

Year 3 =

Month X =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

a =

b =

c =

d =

e =

f =

g =

Dear :

This letter responds to a request for a private letter ruling that Taxpayer filed with the Internal Revenue Service (Service). Taxpayer's letter and subsequent submissions requested an extension of time under § 301.9100 of the Procedure and Administration Regulations to make an election to use the mark-to-market method of accounting under § 475(f)(1) of the Internal Revenue Code, effective for the taxable year that ended calendar year end, Year 2. Taxpayer's request was filed with our office on Date 5.

### **Facts**

Taxpayer is the chief executive officer and co-owner of a privately held company. Due to less demand on his time in that business, Taxpayer dramatically increased his trading of securities during several months of the first half of Year 2. During the last several months of Year 2, however, Taxpayer significantly curtailed his trading activity.

During Year 2, Taxpayer realized \$ a of losses from his securities trading activity. The vast majority of the losses, b percent, were realized after Date 1, the due date for making a mark-to-market election under § 475(f)(1) for Year 2. Further, approximately c percent of Taxpayer's \$ d of disallowed wash sale losses in Year 2 were incurred after the Date 1 due date for making the § 475(f)(1) election. Taxpayer reported on his Year 2 federal income tax return a total capital loss carryover of \$ e at the end of Year 1.

Taxpayer states that he was not familiar with tax aspects of securities trading and was not aware in Month X, Year 2, that his increased trading activity during the first part of Year 2 might have enabled him to claim that he was a trader eligible to make a § 475(f)(1) election. In early Year 3, Taxpayer engaged Accountant, a certified public accountant who has served as Taxpayer's tax return preparer for many years, to prepare his Year 2 federal income tax return. Consistent with the engagement letter, Taxpayer began to provide Accountant his tax information during Month X, Year 3, to

enable Accountant to prepare Taxpayer's Year 2 return. Accountant states that he did not become aware until Date 2 or later that Taxpayer had dramatically increased his trading activity for several months during the first half of Year 2.

After further correspondence with Taxpayer, Accountant advised Taxpayer on or after Date 3, on the requirements to be classified as a trader. Accountant explained to Taxpayer that a § 475(f)(1) election effective for Year 2 would have had to have been made by Date 1, and therefore was too late. Accountant and Taxpayer discussed Taxpayer's ability to pursue relief under § 301.9100-3 to make a § 475(f)(1) election effective for Year 2. Accountant filed a request for an automatic extension to file the Year 2 federal income tax return and looked into submitting a request with the Service for relief under § 301.9100-3 to make a late § 475(f)(1) election.<sup>1</sup>

On Date 4, Taxpayer filed a late § 475(f)(1) election statement for the Year 2 tax year. Taxpayer also filed with the Service a Form 3115, Application for Change in Accounting Method on that date. Taxpayer's Form 3115 requested a Year 2 year of change to change from the "[c]ash method as an investor in securities . . . [to the] [m]ark-to-market method under section 475 for a trader in securities."

Taxpayer submitted a request for a private letter ruling seeking an extension of time under § 301.9100-3 to make a late § 475(f)(1) election for Year 2. This request was filed with the Service on Date 5, more than f months after the due date for filing the § 475(f)(1) election. The request was also made approximately g months after determining that relief would have to be requested from the Service for Taxpayer to make a late election.

On Date 6, Accountant filed Taxpayer's federal income tax return for Year 2 with the Service. Taxpayer filed his Year 2 federal income tax return and reported gains and losses from securities on a mark-to-market basis, presumably based on the assumption that the Service would grant Taxpayer relief to make the late § 475(f)(1) election for Year 2.

### **Law and Analysis**

Taxpayer is not entitled to § 301.9100 relief to make a late § 475(f)(1) election because Taxpayer did not act reasonably and in good faith and granting relief would prejudice the interests of the Government.

#### **Relief under § 301.9100 to make a late § 475(f)(1) election is denied**

Section 475(f)(1) provides that a taxpayer engaged in a trade or business as a

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<sup>1</sup> With that extension, Taxpayer made a tax payment consistent with the amount of tax reported on his subsequently filed Year 2 return.

trader in securities may elect to apply the mark-to-market method of accounting to securities held in connection with such trade or business. Section 7805(d) provides that, except to the extent otherwise provided by the Code, any election shall be made at such time and in such manner as the Secretary shall prescribe.

Revenue Procedure 99-17, 1999-1 C.B. 503, sets forth the requirements for making an election under § 475(f). Under section 5.03 of that revenue procedure, a taxpayer must file its election statement not later than the due date (without regard to any extension) of the original federal income tax return for the taxable year immediately preceding the election year and must attach the statement either to that return or, if applicable, to a request for an extension of time to file that return. Section 5.04 of Rev. Proc. 99-17 sets forth the requirements for the statement. The statement must describe the election being made, the first taxable year for which the election is effective, and, in the case of an election under § 475(f), the trade or business for which the election is made. Section 4 of Rev. Proc. 99-17 provides that an election under § 475(f) determines the method of accounting that an electing taxpayer is required to use for federal income tax purposes for securities subject to the election. Once a valid election is made, the taxpayer is required to use a mark-to-market method of accounting under § 475. Section 4 of Rev. Proc. 99-17 also provides that if a taxpayer fails to change the taxpayer's method of accounting to comply with the election, then the taxpayer is on an impermissible method.

Section 6.01 of Rev. Proc. 99-17<sup>2</sup> provided that a change in a taxpayer's method of accounting is a change in method of accounting to which the provisions of §§ 446 and 481 and the regulations promulgated thereunder apply. Section 6.03 of Rev. Proc. 99-17 generally provided that if a taxpayer changes its method of accounting under section 6.01 of Rev. Proc. 99-17, the taxpayer must take into account the net amount of the § 481(a) adjustment over the applicable period.

Section 23.01 of Rev. Proc. 2017-30, 2017-18 I.R.B. 1131, provides procedures for a trader in securities that has made a § 475(f)(1) election to obtain automatic consent of the Commissioner to change the trader's method of accounting for securities to use the mark-to-market method of accounting under § 475.<sup>3</sup> Section 23.01(4) of Rev. Proc. 2017-30 refers to section 5 of Rev. Proc. 99-17 for the requirements to make a § 475(f)(1) election.

Revenue Procedure 2015-13, 2015-5 I.R.B. 419, sets forth the general procedures under § 446(e) to obtain the consent of the Commissioner to change a method of accounting for federal income tax purposes, including the procedures to obtain the automatic consent of the Commissioner to change a method of accounting in Rev. Proc. 2017-30. Under section 7.02 of Rev. Proc. 2015-13, unless otherwise

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<sup>2</sup> Section 6 of Rev. Proc. 99-17 was superseded by Rev. Proc. 99-49, 1999-2 C.B. 725.

<sup>3</sup> Rev. Proc. 2017-30 was the automatic method change revenue procedure that would have applied to Taxpayer's election filing, had it been timely filed.

provided in a specific change listed in Rev. Proc. 2017-30, a taxpayer making a change in method of accounting must apply § 481(a) and take into account the § 481(a) adjustment in the manner provided in section 7.03 of Rev. Proc. 2015-13.

Section 23.01 of Rev. Proc. 2017-30 does not contain an exception to the rule in section 7.02 of Rev. Proc. 2015-13.

Section 301.9100-1(c) provides, in part, that the Commissioner has discretion to grant a reasonable extension of time to make a regulatory election (defined in § 301.9100-1(b) as an election whose due date is prescribed by regulations published in the Federal Register, or by a revenue ruling, revenue procedure, notice, or announcement published in the Internal Revenue Bulletin). Section 301.9100-1(b) defines the term election to include a request to change an accounting method.

Section 301.9100-3 sets forth rules that the Commissioner must use to determine whether it will grant an extension of time for regulatory elections that do not meet the requirements of § 301.9100-2 for an automatic extension. Generally, a taxpayer must provide sufficient evidence to establish to the satisfaction of the Commissioner that the taxpayer acted reasonably and in good faith, and the grant of relief will not prejudice the interests of the Government.

Except as provided in § 301.9100-3(b)(3), § 301.9100-3(b)(1) provides rules for when a taxpayer is deemed to have acted reasonably and in good faith. Section 301.9100-3(b)(1)(i) provides that a taxpayer will be deemed to have acted reasonably and in good faith if the taxpayer requests relief under § 301.9100-3 before the failure to make the regulatory election is discovered by the Service. Section 301.9100-3(b)(3) provides rules as to when a taxpayer is deemed to have not acted reasonably and in good faith. Section 301.9100-3(b)(3)(iii) provides that a taxpayer is deemed to have not acted reasonably and in good faith if specific facts have changed since the due date for making the election that make the election advantageous to a taxpayer. In such a case, the Service will grant relief only when the taxpayer provides strong proof that the taxpayer's decision to seek relief did not involve hindsight.

Section 301.9100-3(c) provides that the Commissioner will grant a reasonable extension of time to make a regulatory election only when the interests of the Government will not be prejudiced by the granting of relief. Section 301.9100-3(c)(1)(i) provides that the interests of the Government are prejudiced if granting relief would result in a taxpayer having a lower tax liability in the aggregate for all taxable years affected by the election than the taxpayer would have had if the election had been timely made (taking into account the time value of money).

Section 301.9100-3(c)(2) provides special rules for accounting method regulatory elections. Section 301.9100-3(c)(2)(ii) provides that the interests of the Government are deemed to be prejudiced except in unusual and compelling circumstances if the

accounting method regulatory election for which relief is requested requires an adjustment under § 481(a) (or would require an adjustment under § 481(a) if the taxpayer changed to the method of accounting for which relief is requested in a taxable year subsequent to the taxable year the election should have been made).

**a) Taxpayer did not act reasonably and in good faith**

Section 301.9100-3(b)(3)(iii) provides that a taxpayer is deemed to have not acted reasonably and in good faith if specific facts have changed since the due date for making the election that make the election advantageous to a taxpayer. In such a case, the Service will grant relief only when the taxpayer provides strong proof that the taxpayer's decision to seek relief did not involve hindsight.

To make a timely § 475(f)(1) election for Year 2, Taxpayer had to make the § 475(f)(1) election by Date 1, the unextended due date of Taxpayer's federal income tax return for Year 1. Taxpayer did not file his request for relief under § 301.9100-3 until Date 5. The late filing of the § 475(f)(1) election provided Taxpayer the benefit of over 4 months of hindsight. Taxpayer continued to trade during Year 2 and realized the vast majority of his trading losses and wash sale losses after the Date 1 due date for filing a § 475(f)(1) election for Year 2. Taxpayer gained advantage from that hindsight because Taxpayer was able to determine the precise effect of a § 475(f)(1) election with the benefit of knowledge that his ongoing trading activities after the Date 1 due date (a) produced a dramatic increase in realized trading losses and wash sale losses, which under § 475 would receive favorable treatment, and (b) did not produce meaningful gains to absorb the capital losses carrying over from Taxpayer's Year 1 return. Thus, Taxpayer's specific facts materially changed after the due date for making the § 475(f)(1) election, and those specific fact changes made that election advantageous to Taxpayer. Moreover, Taxpayer did not provide strong proof showing that his decision to seek relief did not involve hindsight.<sup>4</sup> Accordingly, under § 301.9100-3(b)(3), Taxpayer is deemed to have not acted reasonably and in good faith.

**b) Granting Relief Would Prejudice the Interests of the Government**

Under § 301.9100-3(c)(2)(ii), the interests of the Government are deemed to be prejudiced, except in unusual and compelling circumstances, if the accounting method regulatory election for which relief is requested requires an adjustment under § 481(a) (or would require an adjustment under § 481(a) if the taxpayer changed to the method of accounting for which relief is requested in a taxable year subsequent to the taxable year the election should have been made). Taxpayer has not presented unusual and compelling circumstances, but instead contends that Taxpayer's accounting method regulatory election is not one that requires Taxpayer to make a § 481(a) adjustment

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<sup>4</sup> Taxpayer did not offer factual proof on this point. Rather, Taxpayer only argued that he would have timely made the election even without knowledge of the factual developments that made the election advantageous.

because he was not engaged in the trade or business of being a trader in securities prior to Year 2.

Taxpayer's argument is misplaced. Section 4 of Rev. Proc. 99-17 states that the election under § 475(f) determines the method of accounting an electing trader is required to use for federal income tax purposes for securities subject to the election. Because making a § 475(f) election is integrally related to making a change in accounting method to use the mark-to-market method of accounting under § 475, it is an accounting method regulatory election subject to § 301.9100-3(c)(2). Further, a § 475(f)(1) election requires a change in method of accounting that requires a § 481(a) adjustment. The change in method of accounting is not permitted to be implemented on a cut-off method.<sup>5</sup>

Since a § 475(f)(1) election is an accounting method regulatory election that requires a § 481(a) adjustment, the interests of the Government are deemed to be prejudiced given that Taxpayer has failed to present unusual and compelling circumstances to justify granting the requested relief.

### **CONCLUSION**

Based on the facts and representations submitted, we conclude that Taxpayer has not satisfied the requirements to justify granting an extension of time to make an election under § 475(f) to use the mark-to-market method of accounting. Specifically, Taxpayer has failed to demonstrate that he has acted reasonably and in good faith, and that the grant of relief will not prejudice the interests of the Government. Accordingly, Taxpayer's request for an extension of time to make an election under § 475(f)(1) for Year 2 is denied.

Except as expressly provided herein, no opinion is expressed or implied concerning the federal tax consequences of the transactions described above. In particular, no opinion is expressed or implied as to whether Taxpayer's securities trading activities constitute those of a trader in securities eligible to make the mark-to-market election under § 475(f)(1).<sup>6</sup> Furthermore, no opinion is expressed on the consequences of Taxpayer's filing of his Year 2 income tax return, with securities trading gains and losses reported on a mark-to-market basis, without having obtained § 301.9100-3 relief to make a late § 475(f)(1) election.

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<sup>5</sup> Example 4 of § 301.9100-3(f) demonstrates that the language in § 301.9100-3(c)(2)(ii) does not apply to accounting method changes that are required to be made on a cut-off basis. By contrast, Example 5 of § 301.9100-3(f) illustrates that the interests of the Government are deemed to be prejudiced under § 301.9100-3(c)(2)(ii) if the facts are varied such that a cut-off method is not permitted for the accounting method change.

<sup>6</sup> Based on the information supplied by Taxpayer, there is an issue whether Taxpayer's trading activity during Year 2 was sufficiently regular, frequent, and continuous for Taxpayer to have been considered engaged in the trade or business of being a trader in securities for purposes of § 475(f)(1).

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This ruling is directed only to the taxpayer that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the terms of a power of attorney on file in this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

Patrick E. White  
Senior Counsel, Branch 3  
Office of the Associate Chief Counsel  
(Financial Institutions and Products)

Enclosures:

Copy of this letter  
Copy for section 6110 purposes

cc: